Supreme Court, U. S.
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In The

Supreme Court of the United States

October Term, 1977

No. 78-14

MIRIAM SAKOL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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No.

MIRIAM SAKOL,

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-against-

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Petitioner, Miriam Sakol, prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered in this case on April 6, 1978, affirming the decision of the United States Tax Court.

Opinions Below

The opinion of the Court of Appeals, which has not yet been officially reported, is annexed hereto as Appendix A, pages 1a to 13a. The opinion of the Tax Court is reported at 67 T.C. 986 (1977). It appears at App. B, pp. 14a to 30a.

Jurisdiction

The judgment of the Court of Appeals sought to be reviewed was entered on April 6, 1978. App. C, pp. 31a to 32a. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

Questions Presented

1. Did the Court below reach a decision in conflict with that of this Court in Heiner v. Donnan, 285 U.S. 312 (1932), by ruling erroneously upon an important constitutional question of the standard of review under the due process clause of the Fifth Amendment of a federal tax statute?

2. Does the decision below conflict with the decision of the Court of Appeals for the Third Circuit in Gurmankin v. Costanzo, 556 F.2d 184 (1977)?

Constitutional Provision and Statute Involved

The Fifth Amendment to the United States Constitution provides:

> "No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against

himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

Section 83(a) of the Internal Revenue Code provides:

"PROPERTY TRANSFERRED IN CONNECTION WITH PERFORMANCE OF SERVICES.

(a) GENERAL RULE.--If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of--

(1) the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over

(2) the amount (if any) paid for such property,

shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such property in an arm's length transaction before his rights

in such property become transferable or not subject to a substantial risk of forfeiture."

Statement of the Case

This case involved the constitutionality of Section 83(a) of the Internal Revenue Code.

On May 7, 1971, petitioner purchased 140 shares of her employer's stock from her employer, Chesebrough-Pond's, Inc. ("Chesebrough"), for $21.20 per share, or $2,968 pursuant to its stock purchase plan. Under the terms of the plan she could not sell, pledge or transfer any interest in the shares for the five-year period ending May 7, 1976.

The petitioner's purchase was also subject to a forfeiture restriction which lapsed on May 7, 1972. Pursuant to Section 83, the taxable event of the petitioner's purchase took place on that date when her shares were no longer subject to a "substantial risk of forfeiture."

On the last business day prior to May 7, 1972, Chesebrough's common stock traded on the New York Stock Exchange at a mean quoted price of $66.50. The respondent included in petitioner's income under Section 83(a) the entire excess of the $66.50 New York Stock Exchange price over her $21.20 cost per share, or $6,342 for the 140 shares. The Court of Appeals, Tax Court and respondent acknowledge that if freely traded shares on the New York Stock Exchange were quoted on the valuation date at $66.50 per share, petitioner's shares subject to a four-year restriction (on the valuation date) against sale, transfer or

pledge were worth significantly less.* However, under the Internal Revenue Code (Section 83(a)) such a four-year restriction is disregarded for purposes of determining petitioner's gross income.

Petitioner's position was that Section 83(a) is unconstitutional because that statute (a) mandates a fictitious valuation of property in excess of its fair market value (thereby requiring petitioner to pay income tax on an amount which is no economic benefit to her); (b) precludes petitioner from proving the actual amount of income which she received; and (c) compels the taxation, as income, of an amount which is not income.

The Tax Court upheld the constitutionality of Section 83(a). The Second Circuit affirmed.

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*The issue of the valuation of the restricted shares was separated for trial from the constitutional issue by Tax Court order, pending final resolution of the constitutional issue.

Reasons for Granting the Writ

I. The decision of the Second Circuit conflicts with decisions of this Court such as Heiner v. Donnan, 285 U.S. 312 (1932), and applies an erroneous standard of due process review to a federal tax statute

The Second Circuit, in affirming the Tax Court, has upheld a tax statute that deprives petitioner of her property in violation of the due process clause of the Fifth Amendment by imposing an income tax measured in part by an amount which has no economic benefit to her. That holding is in direct conflict with the long-established principle enunciated by this Court in Heiner v. Donnan, 285 U.S. 312 (1932); Hoeper v. Tax Commission, 284 U.S. 206 (1931); and Schlesinger v. Wisconsin, 270 U.S. 230 (1926), that a statute which imposes a tax on an amount which is no economic benefit to the taxpayer based upon an assumption of fact which the taxpayer is forbidden to controvert is so arbitrary and unreasonable that it cannot stand under the due process clause of the Fifth Amendment to the Constitution.

The rationale of these earlier tax cases has recently been approved and applied in a number of non-tax cases, i.e., Cleveland Bd. of Educ. v. LaFleur, 414 U.S. 632 (1974); Vlandis v. Kline, 412 U.S. 441 (1973); U.S. Dept. of Agriculture v. Murry, 413 U.S. 508 (1973); and Stanley v. Illinois, 405 U.S. 645 (1972). This Court did not apply (but did not reject) this rationale in Weinberger v. Salfi, 422 U.S. 749 (1975), holding that a different standard of due process review is appropriate for

statutes dealing with claims for non-contractual government benefits.

A. This Court has long held that a statute that imposes a tax on an amount which is no economic benefit to the taxpayer by means of a fictitious conclusive presumption violates due process.

This Court's holdings in Heiner v. Donnan, Hoeper v. Tax Commission and Schlesinger v. Wisconsin are dispositive of the due process violation of Section 83(a).

In Schlesinger v. Wisconsin, petitioner challenged a Wisconsin statute that every gift of a material part of a decedent's estate made by him within six years of death "shall be construed to have been made in contemplation of death" (270 U.S. at 236) for death tax purposes. The Supreme Court held that the statute established an invalid conclusive presumption and declared it to be in violation of due process and equal protection. In Heiner v. Donnan, this Court considered a challenge to the constitutionality of a similar federal estate tax statute (Section 302(c) of the Revenue Act of 1926) providing that gifts made within two years of death of the donor shall "be deemed and held to have been made in contemplation of death" (285 U.S. at 320). In ruling the statute unconstitutional this Court held that the conclusive presumption established by the statute "constitutes an attempt by legislative fiat to enact into existence a fact which here does not, and cannot be made to exist in actuality" (285 U.S. at 329).

The tax statutes involved in Donnan and Schlesinger made relevant the fact of motivation for a gift and then foreclosed the taking of evidence of that fact. Likewise, Section 83(a) of the Code makes fair market value of the restricted property relevant and then precludes evidence on the effect of a contractual restriction on fair market value even when that restriction substantially affects fair market value. The constitutional principle which underlies the decisions in both Donnan and Schlesinger and is applicable here is "...that a statute which imposes a tax upon an assumption of fact which the taxpayer is forbidden to controvert is so arbitrary and unreasonable that it cannot stand under the..." due process clauses of the Fifth and Fourteenth Amendments to the Constitution. (Heiner v. Donnan, 285 U.S. at 325). This Court said in Donnan that it "has held more than once that a statute creating a presumption which operates to deny a fair opportunity to rebut it violates the due process clause...." (285 U.S. at 329).

In Hoeper v. Tax Commission, a Wisconsin statute measured a husband's income with reference to his wife's income for state income tax purposes. Under Wisconsin law a married woman's earnings were her separate property. This Court struck down the state income tax statute which measured an income tax on an amount that was not an economic benefit to the taxpayer. A tax statute which, in effect, presumed a fictitious amount to be an economic benefit was held to violate due process. This Court wrote in Donnan that, "We held [in Hoeper] that, since in law and in fact the wife's income was her separate property, the state was without power to measure his tax in part by the income of his wife." (285 U.S. at 326). Where a federal tax statute measured

estate tax with reference to property which was no economic benefit to the estate, this Court said, in Donnan (285 U.S. at 327):

> "The result is that upon those who succeed to the decedent's estate there is imposed the burden of a tax, measured in part by property...from which the estate deserves no benefit of any description. Plainly this is to measure the tax on A's property by imputing to it in part the value of the property of B, a result which both the Schlesinger and Hoeper cases condemn as arbitrary and a denial of due process of law. Such an exaction is not taxation but spoilation."

The Second Circuit in upholding a tax statute which imposes an income tax on an amount which is no economic benefit to the petitioner (by ignoring a restriction which has a significant effect on value) has reached a decision that is in conflict with these decisions of this Court. The Court below dismisses Donnan and Schlesinger as "plainly not good law today." (App. A, p. 7a). The only direct authority for this statement is a conclusion to that effect in a constitutional law case book by Professor Tribe.

There is far superior authority available that the rationale of the cases upon which petitioner relies represents the state of the law today--this Court has recently approved the rationale of these three tax cases in Cleveland Bd. of Educ. v. LaFleur, 414 U.S. 632, 644 (1974); Vlandis v. Kline, 412 U.S. 441, 446 (1973); U.S. Dept. of Agriculture v. Murry, 413 U.S. 508, 512 (1973); and

Stanley v. Illinois, 405 U.S. 645 (1972).*

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*For example, the Supreme Court stated in Vlandis v. Kline that (412 U.S. at 446):

> "Statutes creating permanent irrebuttable presumptions have long been disfavored under the Due Process Clause of the Fifth and Fourteenth Amendments. In Heiner v. Donnan, 285 U.S. 312, 52 S.Ct. 358, 76 L.Ed. 772 (1932), the Court was faced with a constitutional challenge to a federal statute that created a conclusive presumption that gifts made within two years prior to the donor's death were made in contemplation of death, thus requiring payment by his estate of a higher tax. In holding that this irrefutable assumption was so arbitrary and unreasonable as to deprive the taxpayer of his property without due process of law, the Court stated that it had 'held more than once that a statute creating a presumption which operates to deny a fair opportunity to rebut it violates the due process clause of the Fourteenth Amendment.' Id., at 329, 52 S.Ct., at 362. See, e.g., Schlesinger v. Wisconsin, 270 U.S. 230, 46 S.Ct. 260, 70 L.Ed. 557 (1926); Hoeper v. Tax Comm'n, 284 U.S. 206, 52 S.Ct. 120, 76 L.Ed. 248 (1931)."

B. The standard of due process review set forth in Weinberger v. Salfi, 422 U.S. 749 (1975), is not applicable to a federal tax statute.

The Court below reached its conclusion of the constitutionality of section 83(a) on a singular and misplaced reliance on Weinberger v. Salfi. Contrary to the Second Circuit's interpretation, this Court did not reject the Donnan, Schlesinger and Hoeper rationale in Salfi. Instead, this Court was careful to distinguish two cases that followed that rationale (Stanley and LaFleur) on the ground that Salfi involved merely a claim for a non-contractual government benefit. The Court also distinguished Vlandis, which like Salfi, did involve a government benefit program (in the form of reduced college tuition for in-state residents) on the ground that, since the Connecticut statute tested its benefit by the factual question of residency, it could not at the same time deny to one seeking to meet the residency test the opportunity to show factors clearly bearing on that issue.

Neither Salfi distinction is applicable here. Section 83(a), like the Connecticut statute in Vlandis, makes one fact relevant on the measure of income--the fair market value of the restricted stock--and then excludes evidence of the substantial effect on fair market value of the restriction. Nor is there any support for the Commissioner in applying the minimum Salfi standard of due process review for government benefit programs to such burdens as deprivation of property through estate or income taxation.

The Salfi opinion did not withdraw the Donnan and Schlesinger due process protection from such legislative deprivations of property. Rather, the majority opinion in Salfi only limited judicial due process review to statutes "prescribing the conditions upon which funds shall be dispensed from the public treasury," or those "regulating the private sector of the economy." (422 U.S. at 774). Section 83 of the Internal Revenue Code cannot be characterized as falling within either category.

The Court below appears to find (App. A, p. 5a) support for his thesis that Donnan and Schlesinger no longer have validity in Usery v. Turner Elkhorn Mining Co., 428 U.S. 1 (1976). Here again, it selects a few words in an opinion of this Court, out of context, and thereby claims that Turner is authority for the proposition that the limited Salfi standard applies to all statutes regulating economic matters. In Turner, this Court upheld a statute "regulating the private sector of the economy" by providing benefits to coal miners suffering from "blacklung disease", and stated (428 U.S. at 23-24):

> "Since Congress can clearly draft a statute to accomplish precisely what it has accomplished through §411(c)(3)'s presumption of disability, the argument is essentially that Congress has accomplished its result in an impermissible manner--by defining eligibility in terms of 'total disability' and enacting an 'irrebuttable presumption' of total disability upon a factual showing that does not necessarily satisfy the statutory definition of total disability. But in a statute such as this, regulating purely economic matters, we do not think that Congress' choice of statutory language can invalidate the

enactment when its operation and effect are clearly permissible. Cf. Weinberger v. Salfi...."

The equation between statutes regulating economic matters in the private sector of the economy and an income tax statute does not exist. Nowhere in Salfi or Turner is there any indication, let alone a conclusion, that the due process review of a federal income tax statute would be judged under the Salfi standard.

It should also be noted that Justice Marshall, in his majority opinion (428 U.S. at 24) in Turner, distinguished Stanley and Vlandis on the ground that Congress could directly legislate for coal mine operators to provide benefits for miners suffering complicated pneumoconiosis and, therefore, that it chose to legislate by means of presuming compensable "total disability" by clinical evidence of complicated pneumoconiosis is not violative of due process. This distinction is not applicable here. Congress cannot directly legislate that an amount is "income" by labelling as income something which has no economic value or benefit. The due process clause is violated when a statute puts upon a taxpayer "the burden of a tax measured in part by the value of the property never owned by him...." (Heiner v. Donnan, 285 U.S. at 328. This Court has stated "that which is not in fact the taxpayer's income cannot be made such by calling it income" (Hoeper v. Tax Commission, 284 U.S. at 215 (1931), and these holdings are good law today.

II. The decision of the Court below is in direct conflict with the Third Circuit's decision in Gurmankin v. Costanzo, 556 F.2d 184 (1977)

The decision below represents the second time that a Court of Appeals was faced with the argument that Salfi, in effect, overruled Donnan, Schlesinger and the recent cases including Vlandis and LaFleur that have followed their rationale.

The Third Circuit, however, came to the opposite conclusion than the Court below. In Gurmankin v. Costanzo, supra, the Third Circuit held a Philadelphia School District policy of preventing blind teachers from teaching sighted students created an irrebuttable presumption that blind persons could not be competent teachers in violation of due process. The Third Circuit relied on Cleveland Board of Education v. LaFleur, 414 U.S. 632 (1974), which held unconstitutional regulations requiring that teachers take leaves of absence in the fifth or sixth month of pregnancy. The irrebuttable presumption of disability was struck down in LaFleur as not being universally true under the Vlandis case which relied on Donnan, Schlesinger and Hoeper for its support.

The School Board argued that Salfi had overruled LaFleur, just as the respondent argued in the Court below that Salfi had overruled Donnan, Schlesinger and Hoeper. The Third Circuit rejected the argument that Salfi had overruled LaFleur because "Salfi is distinguishable because it is a government benefits case." (556 F.2d at 187).

The expanded reading of Salfi, rejected by the Third Circuit in Gurmankin, has been adopted in error by the Court below.*

It is respectfully submitted that the conflict between the Second and Third Circuits and the uncertainty which that conflict has created as to the scope and application of the Salfi limitation on the irrebuttable presumption doctrine justify the grant of certiorari and resolution of the conflict by this Court.

Conclusion

For all of the foregoing reasons it is respectfully submitted that certiorari should be granted.

Dated: New York, New York
July 3, 1978

Respectfully submitted,

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*This issue was also raised, but not decided by the Seventh Circuit in Miller v. Carter, 547 F.2d 1314 (1977), aff'd, per curiam, 98 S.Ct. 786 (1978).

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 355—September Term, 1977.

(Argued January 13, 1978 Decided April 6, 1978.)

Docket No. 77-4143

MIRIAM SAKOL,

Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

Before:

FEINBERG and OAKES, *Circuit Judges,*
and WYATT, *District Judge.**

Appeal from a decision of the United States Tax Court upholding the constitutionality of 26 U.S.C. § 83(a) under the Fifth and Sixteenth Amendments.

Affirmed.

BURTON G. LIPSKY, New York, N.Y. (Delson & Gordon, New York, N.Y., of counsel), *for Appellant.*

WILLIAM A. FRIEDLANDER, Washington, D.C. (M. Carr Ferguson, Assistant Attorney General, Gilbert E. Andrews, Jonathan S.

* Of the Southern District of New York, sitting by designation.

Cohen, Tax Division, Department of Justice, Washington, D.C., of counsel), *for Appellee.*

OAKES, *Circuit Judge:*

Is it constitutional under the Fifth and Sixteenth Amendments for Congress, in taxing a corporate employee in connection with his purchase of his employer's stock, not to take into account any diminution in value of the stock that may be present by virtue of temporary restrictions on transfer in the employer's underlying stock purchase plan? Section 83(a) of the Internal Revenue Code governs the taxation of certain stock transfers to employees "in connection with the performance of services."[1] It requires a taxpayer to include in gross income the excess of the stock's fair market value over its cost, as soon as the taxpayer's interest is no longer subject to a substantial risk

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1 Section 83(a), which is not confined to transfers of stock, provides:

> Property transferred in connection with performance of services
>
> (a) General rule.—If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of—
>
> (1) the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over
>
> (2) the amount (if any) paid for such property,
>
> shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such property in an arm's length transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

26 U.S.C. § 83(a).

of forfeiture. The actual value of the stock arguably may be less than the value of stock readily transferable on the open market because of restrictions imposed by the stock purchase plan. Nevertheless, these restrictions, other than permanent, nonlapsing restrictions, may not be considered in determining fair market value. Appellant argues that the Tax Court erroneously concluded that the statute was constitutional under the Fifth and Sixteenth Amendments. 67 T.C. 986 (Mar. 23, 1977). We disagree, and accordingly affirm the Tax Court.

I. Facts and Proceedings Below

During 1972, taxpayer was employed by Chesebrough-Pond's Inc. (Chesebrough). Chesebrough offered to its officers and administrative employees a stock purchase plan under a standard stock purchase agreement. The agreement, executed by all purchasers, provided that one dollar par value common stock could be purchased for an amount equal to fourteen times Chesebrough's average per share earnings during the preceding five years. It also contained a restriction on transfer referred to below.

On May 7, 1971, taxpayer agreed to purchase 140 shares at $21.20 per share. For a period of one year thereafter, her shares were subject to forfeiture if she ceased to be employed by Chesebrough for any reason other than death.[2] In addition, she was bound not to sell, pledge or transfer any interest in the shares for a five-year period ending May 7, 1976.[3] The transfer restriction, however, could be waived by Chesebrough.

As of May 7, 1972, taxpayer's 140 shares were no longer subject to forfeiture. Thus, the excess of the stock's fair

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2 The shares were forfeitable at a price equal to that paid by her.

3 Chesebrough was willing to retain the shares for safekeeping until expiration of the five-year restriction period. Shares delivered were to bear a legend noting the transferability restrictions.

market value over its cost became includable in taxpayer's gross income in the 1972 tax year.[4] On the last business day prior to May 7, the average New York Stock Exchange quotation for Chesebrough stock was $66.50 per share. Taxpayer's required inclusion under the statute, therefore, is measured by the difference between her cost of $21.20 and the market price of $66.50, or $45.30 per share for a total of $6,342. Because taxpayer both included the $6,342 in gross income and then deducted that amount in arriving at her adjusted gross income, the Commissioner determined a deficiency. It was in a redetermination petition that taxpayer challenged the constitutionality of Section 83(a).

II. Discussion

A. *The Fifth Amendment Ground*

Appellant rests her Fifth Amendment argument on the irrebuttable presumption doctrine.[5] She contends that the conclusive legislative generalization embodied in Section 83(a) violates the Due Process clause because the statute imposes a tax on an amount "which . . . does not,

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4 *See* note 1 & accompanying text *supra*. Under 26 U.S.C. §§ 421-25, transfers of stock to an employee exercising a "qualified stock option," *id.* § 422, an option under a qualified "employee stock purchase plan," *id.* § 423, and certain "grandfathered" restricted stock options, *id.* § 424, receive more favorable tax treatment than permitted by Section 83(a).

5 *See, e.g., Vlandis* v. *Kline*, 412 U.S. 441, 452 (1973) (conclusive presumption of nonresidence held unconstitutional since the presumption "is not necessarily or universally true in fact, and . . . the State has reasonable alternative means of making the crucial determination"); *Crawford* v. *Cushman*, 531 F.2d 1114, 1124-26 (2d Cir. 1976) (mandatory discharge from Marine Corps for pregnancy violates equal protection and creates an unconstitutional irrebutable presumption in violation of the Due Process clause). For one critique of the doctrine, see Note, *The Irrebuttable Presumption Doctrine in the Supreme Court*, 87 Harv. L. Rev. 1534, 1544-56 (1974).

and cannot be made to, exist in actuality . . . ." *Heiner* v. *Donnan*, 285 U.S. 312, 329 (1932).[6]

The doctrinal underpinning for taxpayer's argument flowered in the early 1970's when the dormant irrebuttable presumption doctrine was revived in constitutional analysis. *See, e.g., Vlandis* v. *Kline*, 412 U.S. 441 (1973) (holding unconstitutional a conclusive presumption of nonresidence whenever a person applied to a Connecticut state university from out of state); *Cleveland Board of Education* v. *LaFleur*, 414 U.S. 632 (1974) (invalidating local education board rules requiring pregnant teachers to take maternity leave without pay a specified number of months before and after the expected birth of her child).[7] Earlier, *Heiner* with the aid of this analysis, had held unconstitutional a federal statutory presumption that gifts made within two years of a donor's death were made in contemplation of death.[8]

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6 To illustrate the point, counsel for taxpayer at oral argument suggested hypothetically that the restrictions on the stock reduced its value from $66.50 per share to perhaps $45.00 per share. Thus, taxpayer argued, she should have included in her return only the difference between the value as depreciated by the restrictions and her cost.

7 *See also United States Dep't of Agriculture* v. *Murry*, 413 U.S. 508, 514 (1973) (provision of Food Stamp Act denying eligibility to a household which has a member 18 years or older who is claimed as a federal income tax dependent by a taxpayer who is not a member of an eligible household held unconstitutional); *Stanley* v. *Illinois*, 405 U.S. 645, 658 (1972) (statute presuming that unmarried fathers are unfit to take custody of their children upon mother's death is unconstitutional); *Bell* v. *Burson*, 402 U.S. 535 (1971) (statute providing that an uninsured motorist involved in an accident loses his license without a hearing pending a final determination of liability held unconstitutional).

8 In addition to relying specifically on *Heiner* v. *Donnan*, 285 U.S. 312 (1932), the Court in *Vlandis* v. *Kline*, *supra*, 412 U.S. at 446, also cited *Schlesinger* v. *Wisconsin*, 270 U.S. 230 (1926), holding unconstitutional a *state* statute which conclusively presumed that gifts made within six years of the donor's death were made in contemplation of death.

More recently, however, the Court has narrowed the broad scope of the irrebuttable presumption doctrine[9] evinced in *Vlandis* and progeny. *See* note 7 *supra*. For example, *Weinberger* v. *Salfi*, 422 U.S. 749 (1975), upheld a federal statute precluding widows and their children from receiving Social Security survivors' benefits unless the claimant's relationship to the wage-earner existed at least nine months before his death. The Court articulated a rational relationship test for testing the validity of conclusive legislative presumptions in the context of a "non-contractual claim to receive funds from the public treasury," *id.* at 772:

> The question is whether Congress, its concern having been reasonably aroused by the possibility of an abuse which it legitimately desired to avoid, could rationally have concluded both that a particular limitation or qualification would protect against its occurrence, and that the expense and other difficulties of individual determinations justified the inherent imprecision of a prophylactic rule.

Id. at 777. The extent of the *Weinberger* v. *Salfi* limitation on the scope of the irrebuttable presumption doctrine was apparently clarified in *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976). *Turner Elkhorn* validated a federal law utilizing two irrebuttable presumptions: a miner "afflicted with complicated pneumoconiosis is [conclusively deemed] to be totally disabled due to pneumoconiosis; if he has died, it is [also] irrebuttably presumed that he was totally disabled by pneumoconiosis at the time of his death, and that his death was due to pneumoconiosis." *Id.*

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9 This development was perhaps presaged in *Mourning* v. *Family Publications Serv., Inc.*, 411 U.S. 356, 377 (1973) (upholding constitutionality of truth-in-lending rules requiring disclosure when installment purchase provides for four or more payments).

at 11. The Court sustained this potentially overinclusive legislative determination on the basis that Congress is ordinarily accorded great leeway in "regulating purely economic matters." *Id.* at 23-24. And it emphasized that conclusive presumptions in economic matters cannot be "equat[ed]" with presumptions "in the mold of *Stanley* and *Vlandis*." *Id.* at 22.

While it is difficult to reconcile all of the Supreme Court's pronouncements on the irrebuttable presumption doctrine,[10] it seems that in the wake of *Turner Elkhorn* and *Salfi* "purely economic matters" will not be subject to the demanding test of *Vlandis* v. *Kline*, *see* note 5 *supra*, but rather will be governed by *Turner Elkhorn's* more deferential standard of review.[11] That is to say congressional judgments in the form of "irrebuttable presumptions" in the economic area will be upheld where there is a rational relationship between the criteria set forth in the statutory mandate and a legitimate congressional purpose. *See Goldberg* v. *Weinberger*, 546 F.2d 477, 480 (2d Cir. 1976), *cert. denied*, 431 U.S. 937 (1977) (rational relationship test appropriate for due process and equal protection challenge to Social Security law denying certain benefits to widows who remarry before reaching age 60); *cf. Image Carrier Corp.* v. *Beame*, 567 F.2d 1197, 1202-03 (2d Cir. 1977)

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10 Professor Tribe has carefully detailed the problems in reconciling the various irrebuttable presumption decisions of the High Court. *See* L. Tribe, *American Constitutional Law* § 16-32, 1095-96 & n.25 (1978). But we are as satisfied as he that the early tax cases, *Heiner* v. *Donnan*, *supra*, and *Schlesinger* v. *Wisconsin*, *supra*, although cited with approval in *Vlandis* v. *Kline*, *supra*, 412 U.S. at 446, are "plainly not good law today." L. Tribe, *supra*, at 1095 n.25. They can no longer withstand analysis in the light of *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976), *Weinberger* v. *Salfi*, 422 U.S. 749 (1975), and *Mourning* v. *Family Publications Serv., Inc.*, *supra*.

11 *Cf.* Tribe, *Structural Due Process*, 10 Harv. C.R.-C.L. L. Rev. 269, 310-14 (1975) (individualized inquiry more fitting where fundamental rights are involved).

(rational relationship test appropriate for equal protection challenge to economic regulation).

Applying, then, the rational relationship test to Section 83(a), we note and the taxpayer concedes, Brief for Appellant at 19, that Congress could legitimately have judged that the law prior to the enactment of Section 83 permitted undue income tax avoidance through the use of restricted stock options. The value received by the employee was not taken into income until the restrictions lapsed,[12] yet such arrangements generally permitted taxpayers to enjoy the voting and dividend benefits of stock ownership, despite restrictions on transfer. Section 83(a), which entered the Internal Revenue Code as part of the Tax Reform Act of 1969,[13] was a congressional attempt to eliminate such tax avoidance, clearly a legitimate governmental purpose. While taxpayer takes exception to the possibly overbroad means utilized to effectuate the congressional purpose, the statutory scheme[14] satisfies constitutional standards of rationality for three reasons.

First, whatever depreciating effect transfer restrictions may have on stock value adversely affects only the taxpayer-employee who wishes to sell his stock during the restriction period and is denied the right to do so by the corporation. Prior to enactment of Section 83 most of these restrictions were cooperatively imposed by the corporation

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12 In addition to deferring taxation, prior law operated to convert ordinary income into capital gain. Moreover, the capital gain was long-term since the holding period commenced at the time of acquisition of the restricted stock. *See* Mertens, *Federal Income Taxation*, Code Commentary § 83, at 98 (Malone ed. 1971).

13 Section 83(a) was added to the Code by Section 321(a) of the Tax Reform Act of 1969, Pub. L. 91-172, 83 Stat. 487, 588 (1969).

14 The method adopted to deal with what was essentially a timing problem has two facets: delaying the time of recognition until no substantial risk of forfeiture remains, while ignoring any value-depressing effect of transfer restrictions. *See* note 1 *supra;* notes 21-22 *infra.*

with the aim of providing a tax benefit to the employee rather than advancing purely corporate objectives. Section 83(a) is a reasonably well tailored means of defeating a device the only business purpose of which could be to pay employees with dollars that, because they may be tax-free or tax-favored, may be fewer. Second, the corporation always retains, expressly or by implication of law, the power to waive any restriction. The waiver power thus renders the amount of value depreciation both speculative and dependent upon the subjective intentions of the parties to the plan. Congress was therefore justified in adopting nonindividualistic means, *see* note 11 *supra,* because the factual determinations otherwise necessary accurately to value the shares would depend upon matters entirely within the knowledge and control of the corporate employer and its employee. Since a corporation such as Chesebrough could always release its employee from the restrictions, determining share value with any degree of certainty would be most difficult, expensive and, to the tax collector, administratively inordinately inconvenient. *See Mathews* v. *Lucas,* 427 U.S. 495, 509-10 (1976). Finally, it is not insignificant that those who choose to participate in a restricted stock option purchase plan do so voluntarily, presumably aware of Section 83's tax consequences. That taxpayers participate in such plans with open eyes minimizes the arbitrariness which flows from the lack of perfect fit between the congressional means and its purpose.

Section 83(a) creates a blanket rule, to be sure, unfair perhaps in an individual case, that transfer restrictions generally are to be given no effect in computing the Section 83(a) inclusion. We nevertheless find the requisite rational relationship between congressional means and the legitimate congressional purpose in curbing tax avoidance from the use of restricted stock options. The statutory scheme does not exhibit the kind of "extreme and glaring"

disregard of "fair dealing," *Cohan* v. *Commissioner*, 39 F.2d 540, 545 (2d Cir. 1930), which amounts to confiscation, rather than taxation, in violation of the Fifth Amendment.

B. *The Sixteenth Amendment Ground*

Taxpayer's second contention is premised on the Sixteenth Amendment[15] and the well-known, but often distinguished, decision in *Eisner* v. *Macomber*, 252 U.S. 189 (1920). That case, the only Supreme Court decision ever to hold an income tax provision unconstitutional on Sixteenth Amendment grounds, concluded that Congress had no power to tax stock dividends as income without apportionment. Taxpayer urges *Eisner*'s applicability because her tax liability was computed on the basis of the value of freely transferable stock, an amount in excess of the actual fair market value of her restricted stock. *See* note 6 & accompanying text *supra*. She suggests that Section 83(a) imposes an unapportioned direct tax on property because it is a tax on unrealized income. We are unable to accept this proposition.

The tax here levied was not a direct tax on property but was rather a tax on the receipt of value transferred to an employee by an employer in return for services. It was, therefore, a tax on income received as compensation for services. Thus, if appellant's position were that a direct tax on property is implicated because her compensation was in the form of stock, the argument would be plainly off base. Tax on compensation, whether received in cash or some other form of property, need not be apportioned.

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15 "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const. amend. XVI.

See Springer v. *United States*, 102 U.S. 586, 602 (1880); *Penn Mutual Indemnity Co.* v. *Commissioner*, 32 T.C. 653, 659-66 (1969) (en banc), *aff'd*, 277 F.2d 16 (3d Cir. 1960).

However, appellant's real argument appears to be that she should be taxed only on the compensation she actually received—the value of the stock with the restrictions. Relying on the language of *Eisner*, she urges that income must in fact be realized before it can be taxed, and that the realization requirement carries with it the additional implication that an amount greater than value actully derived is not income within the meaning of the Sixteenth Amendment. But the *Eisner* concept that there must be "gain" to have "income," *Eisner* v. *Macomber*, *supra*, 252 U.S. at 207, has been modified by subsequent decisions. Among these are decisions accepting the accrual method of accounting,[16] adopting the doctrine of constructive receipt,[17] and disallowing the shifting of taxation burdens by assignment of income or by certain transfers in trust.[18] These decisions recognize that concepts of income are dynamic, not static—elastic, not rigid. 1 Mertens, *Federal Income Taxation* § 5.03, at 4-8 (Malone ed. 1974).

We conclude that a workable, practical system[19] of taxing employees' restricted stock options can overlook, at

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16 *E.g.*, *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359, 364-66 (1931) (Sixteenth Amendment permits accrual method); *Aluminum Castings Co.* v. *Routzahn*, 282 U.S. 92, 97 (1930) (accrual method "born of necessity").

17 *E.g.*, *Corliss* v. *Bowers*, 281 U.S. 376, 378 (1930) (grantor taxable on transfer in trust where he retains right to alter, amend or revoke trust).

18 *E.g.*, *Helvering* v. *Horst*, 311 U.S. 112 (1940) (assignment of income); *Helvering* v. *Clifford*, 309 U.S. 331 (1940) (grantor taxable on income of five-year trust even though income was payable to his wife, since grantor retained sufficient incidents of ownership).

19 *See, e.g.*, *Burnet* v. *Sanford & Brooks Co.*, *supra*, 282 U.S. at 365; *Farmers Loan & Trust Co.* v. *Minnesota*, 280 U.S. 204, 212 (1930).

least temporarily,[20] a speculative decrease in value in ascertaining the amount of compensation received in the form of restricted stock where the employee has obtained both voting power and dividend rights. Absent the statute, some stock restrictions might in the abstract make determination of a fair market value exceedingly difficult or downright impossible. *See Helvering* v. *Tex-Penn Oil Co.*, 300 U.S. 481, 499 (1937). By the statute, Congress has drawn a decisive line between restrictions which either defer taxation[21] or by their own terms affect the fair market value calculation[22] and those restrictions which are not considered in measuring fair market value. Congress is not required to take each and every restriction into account in combating tax-avoidance, or to make equally difficult individual evaluations which depend upon the parties' subjective intentions. Rather, the Sixteenth, and Fifth, Amendments permit the line drawn to be a rough one, in the interest of realistically solving a practical problem, by making a "gross accommodation to the economic reality." *Fraser* v. *Commissioner*, 25 F.2d 653, 655 (2d Cir. 1928) (L. Hand, *J.*). Congress has distinguished qualified from

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20 Because her basis for the acquisition of the stock will be its Section 83(a) value, if she sells it for less she will be entitled at least to capital loss treatment. In the end, then, Section 83 relates principally to the timing of taxation rather than to what is being taxed.

21 Until the employee's ownership interest is not subject to a substantial risk of forfeiture, there is no taxation under Section 83(a). *See* note 1 *supra*.

22 Restrictions that will never lapse are taken into account in determining fair market value. *See* note 1 *supra*. Thus, where the stock may be sold only at book value or at a value fixed by formula, if the restriction will never lapse, that formula-determined value is deemed to be the fair market value unless the Commissioner proves the contrary. 26 U.S.C. § 83(d)(1). "In such a case," runs the legislative rationale, "the restriction is an inherent limitation on the recipient's property rights, and his income should be determined accordingly. S. Rep. No. 91-552, 91st Cong., 1st Sess. 121, *reprinted in* [1969] U.S. Code Cong. & Ad. News 2027, 2153.

nonqualified stock option plans and in connection with the latter it has drawn a sharp line of differentiation on the basis of forfeiture and a rough one on the basis of value. Because nonqualified plans have been the vehicles of tax avoidance Congress may clothe the tax incidental to them with a ready-made, rather than a custom-tailored, suit.

Judgment affirmed. No costs.

67 T. C. No. 81

UNITED STATES TAX COURT

MIRIAM SAKOL, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 4834-74 Filed March 23, 1977

Sec. 83(a), I.R.C. 1954, measures income from the transfer of property in connection with the performance of services without regard to contractual restraints on the transfer of that property which will lapse. Held, sec. 83(a) is not unconstitutional under the 5th or 16th Amendments.

Burton G. Lipsky, for the petitioner.

Patrick Matwiczyk, for the respondent.

OPINION

GOFFE, Judge: The Commissioner determined a deficiency in petitioner's Federal income tax for the taxable year 1972 in the amount of $3,318.80. Concessions having been made, the sole issue for decision is whether section 83(a)1/ is unconstitutional because it measures petitioner's gross income derived from an employee stock purchase agreement without regard

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1/ All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise noted.

to certain contractually imposed restrictions on the transferability of the shares purchased under the agreement.

All the facts have been stipulated and are so found. Ms. Miriam Sakol (petitioner) filed her Federal income tax return for the taxable year 1972 with the Internal Revenue Service Center, Holtsville, New York. At the time the petition was filed, petitioner resided in New York City, New York.

During 1972 petitioner was employed by Chesebrough-Pond's, Inc. (Chesebrough), which had in effect a stock purchase plan for its officers and administrative employees (the plan). Officers and employees electing to purchase stock under the plan were required to enter into a stock purchase agreement with Chesebrough. The standard agreement provided that $1 par value common stock could be purchased for an amount equal to 14 times Chesebrough's average per share earnings during the preceding five years. Payment of the purchase price could be made in installments over a period not to exceed five years, however, the employee could prepay the balance at any time. Shares purchased under the agreement would not be issued or delivered and title to the purchased shares would not vest in the employee until the purchase price was paid in full.

On May 7, 1971, petitioner entered into such a stock purchase agreement with Chesebrough, agreeing to purchase 140 shares of $1 par value common stock at a price of $21.20 per share. For a period of one year, the shares purchased by petitioner were subject to forfeiture at a price equal to that paid by her in the event that she ceased to be employed by Chesebrough for any reason other than death.

In addition, petitioner agreed that she would continue to own and not sell, pledge or transfer any interest in the shares for a period of five years or until May 7, 1976. Chesebrough was willing to retain the shares for safekeeping until the expiration of the five-year period, and shares delivered to petitioner would bear a legend noting the restrictions on the transferability of the shares.

On Sunday, May 7, 1972, the 140 shares acquired by petitioner were no longer subject to forfeiture. On the last business day prior to that date, the average New York Stock Exchange price quotation for Chesebrough common stock was $66.50 per share. Therefore, the difference between the average market price of Chesebrough common and the amount paid by petitioner for her shares acquired under the stock purchase agreement was $6,342 when the shares were no longer subject to forfeiture. The Commissioner, in his statutory notice of deficiency, determined that this amount represented compensation for services, includable in petitioner's gross income pursuant to section 83(a) for the taxable year 1972.

Petitioner has launched a serious constitutional assault on section 83(a) on two fronts. On one front, petitioner contends that the section imposes a "conclusive presumption" as to the amount of income derived from the May 7, 1971, stock purchase without fair opportunity to rebut and, therefore, amounts to a denial of due process of law within the meaning of the Fifth Amendment of the Constitution of the United States. On the other, she contends that section 83(a) disregards certain restrictions on transferability in defining income, exceeding the power granted to Congress by the 16th Amendment.

From the outset it is important to note the presumption in favor of the validity of an act of Congress, which is particularly strong in the case of a taxing statute. Penn Mutual Indemnity Co., 32 T.C. 653, 658 (1959). Moreover, a revenue measure will not, in general, be set aside if any state of facts can be shown to rationally justify the provision. United States v. Maryland Savings-Share Insurance Corp., 400 U.S. 4, 6 (1970).

Section 832/ is the Congressional response to certain tax advantages which could be

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2/ SEC. 83. PROPERTY TRANSFERRED IN CONNECTION WITH PERFORMANCE OF SERVICES.

(a) GENERAL RULE.--If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of--

(1) the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over

(2) the amount (if any) paid for such property,

[continued on next page]

2/ [continued]

shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such property in an arm's length transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

* * *

(c) SPECIAL RULES.--For purposes of this section--

(1) SUBSTANTIAL RISK OF FORFEITURE.--The rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by any individual.

(2) TRANSFERABILITY OF PROPERTY.--The rights of a person in property are transferable only if the rights in such property of any transferee are not subject to a substantial risk of forfeiture.

obtained through use of restricted stock plans3/ to compensate employees. The section provides that property transferred in connection with the performance of services is to be included in the income of the transferee in an amount which exceeds the employee's cost by the fair market value of the property transferred, without regard to any contractual restriction on its disposition except a restriction which by its terms will never lapse. The proper time to include that amount is deemed to be the taxable year in which the property is transferable or no longer subject to a substantial risk of forfeiture.

To properly evaluate petitioner's attack on section 83, it is helpful to consider the background of restricted stock purchase plans and the unwarranted tax avoidance made possible by their use.

Restricted stock purchase plans become more popular after two decisions of this Court. In Harold H. Kuchman, 18 T.C. 154 (1952), we held that stock issued under an agreement restricting its disposition prevented the stock from having a fair market value when acquired and, therefore, did not require reporting income at the time the stock was issued. Previously, in Robert Lehman, 17 T.C. 652 (1951), we held that income was not realized when the restrictions terminated, thus taxation was deferred until the subsequent disposition of the property. In 1956, regulations were proposed to the effect that income would be realized in an amount equal to the fair market value of the property over the employee's cost

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3/ See S. Rept. No. 91-552, 91 Cong. 1st Sess. (1969), 1969-3 C.B. 500.

at the time the restrictions lapsed. The regulations adopted in 1959 as section 1.421-6 (d)(2), Income Tax Regs., provided, with respect to bargain purchases of stock subject to restrictions having a significant effect on value, that tax would be imposed only when the restrictions lapsed or the property was sold in an arm's-length transaction. However, the measure of income was changed. The amount taxable as ordinary income was the lesser of the fair market value of the stock at the time of its acquisition, determined without regard to any restrictions, or at the time the restrictions lapsed, over the employee's cost of the stock.

Quite obviously, under this scheme, substantial benefits were available to an employee in a restricted stock purchase plan. Dividends were immediately available while the tax on the value of the shares was deferred and capital gains treatment was accorded the capital appreciation occurring in the period between the acquisition of the stock and the lapse of the restrictions.

In 1968 regulations were again proposed4/ which would have taxed the fair market value of the restricted stock at the time of the lapse of the restrictions, thereby eliminating the capital gain potential on the post-acquisition appreciation. However, it was at this point that Congress responded with section 83, designed to reduce the potential for tax avoidance and to accord more equitable treatment to similar deferred compensation arrangements. S. Rept. No. 91-552, 91 Cong., 1st

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4/ Sec. 1.421-6, Income Tax Regs., 33 Fed. Reg. 15870 (1968).

Sess. (1969), 1969-3 C.B. 500, is clear in this regard:

> General reasons for change.--The present law treatment of restricted stock plans is significantly more generous than the treatment specifically provided in the law for other types of similarly funded deferred compensation arrangements. An example of this disparity can be seen by comparing the situation where stock is placed in a non-exempt employees' trust rather than given directly to the employee subject to restrictions. If an employer transfers stock to a trust for an employee and the trust provides that the employee will receive the stock at the end of 5 years if he is alive at that time, the employee is treated as receiving and is taxed on the value of the stock at the time of the transfer. However, if the employer, instead of contributing the stock to the trust, gives the stock directly to the employee subject to the restriction that it cannot be sold for 5 years, then the employee's tax is deferred until the end of the 5-year period. In the latter situation, the employee actually possesses the stock, can vote it, and receives the dividends, yet his tax is deferred. In the case of the trust, he may have none of these benefits, yet he is taxed at the time the stock is transferred to the trust.

Congress resolved to alter the timing of the recognition of income derived from such stock purchase agreements. Income would be recognized at such time as the shares were either transferable, as defined in the statute, or when they were no longer subject to a substantial risk of forfeiture.

In addition, to minimize the potential for continued tax avoidance and to further discourage the use of restricted stock purchase plans as a means of obtaining an equity interest in one's employer, Congress decided to measure the income derived from such arrangements without regard to transitory restrictions imposed by the parties on the shares purchased.

Petitioner maintains that section 83, in disregarding contractual restrictions, imposes a tax on an amount which has not been realized and, therefore, is not income within the purview of the 16th Amendment.

In support of this contention, petitioner relies on language extracted from two early cases, MacLaughlin v. Alliance Ins. Co., 286 U.S. 244 (1932), and Eisner v. Macomber, 252 U.S. 189 (1920). However, in our view petitioner has placed too much reliance on these cases and the Supreme Court's long-abandoned effort to fashion a concept of income. The powers granted to the Congress to define income are broad and plenary. Penn Mutual Indemnity Co., 32 T.C. 653, 666 (1959). The formalistic concept of realization articulated in the cases upon which petitioner relies has been eroded by the passage of time and subsequent cases and clearly was never intended to define for all times the parameters of income subject to taxation. Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955); Helvering v. Horst, 311 U.S. 112 (1940); Helvering v. Bruun, 309 U.S. 461 (1940). Moreover, taxation despite nonreceipt is common and the actual reduction to possession is not a constitutional requirement. See, e.g., Harrison v. Schaffner, 312 U.S. 579 (1941); Helvering v. Horst, supra; Lucas v. Earl, 281 U.S. 111 (1930).

In any event, the 16th Amendment is not a limitation on the taxing power granted to Congress by the Constitution. It is, instead, designed to insure that the power to tax income is not placed into the category of direct taxation subject to apportionment. It is clear that section 83 does not impose a direct tax within the meaning of the Constitution and, therefore, is entirely within the taxing power of Congress under article 1, section 8, without regard to the 16th Amendment. Cf. Spreckels Sugar Refining Co. v. McClain, 192 U.S. 397 (1904). See also, Penn Mutual Indemnity Co., supra, at 662-663. Accordingly, we hold that section 83 does not exceed the Congressional authority to tax income.

Although an amount may properly be viewed as income within the meaning of the Constitution, the question remains whether the imposition of a tax on that amount is consonant with due process under the Fifth Amendment. Riverfront Groves, Inc., 60 T.C. 435 (1973).

Herein, petitioner takes the position that her income may not exceed the fair market value of the restricted stock she received under the agreement. She argues that section 83, in its conclusive measurement of income without regard to the restrictions on the transferability of her shares, is so arbitrary and unreasonable as to amount to a denial of due process within the meaning of the Fifth Amendment.

On its face, section 83 does not utilize the language of presumptions; it merely defines income earned when property is received "in connection with the performance of services." However, the substance and impact of the section is substantially the same as a conclu-

sive presumption of the amount of income. In recent years, a considerable body of law has developed with regard to conclusive presumptions and the due process clause of the Fifth Amendment. See, e.g., Cleveland Board of Education v. LaFleur, 414 U.S. 632 (1974); Vlandis v. Kline, 412 U.S. 441 (1973); U.S. Dept. of Agriculture v. Murry, 413 U.S. 508 (1973). Much of the analysis applied in these cases can be traced to Heiner v. Donnan, 285 U.S. 312 (1932), and Schlesinger v. Wisconsin, 270 U.S. 230 (1926), upon which petitioner relies herein.

In Donnan,5/ an estate tax case, the Court found unconstitutional under the due process clause section 302(c) of the Revenue Act of 1926 which deemed any transfer made by a decedent within two years of death to have been made in contemplation of death and, therefore, includable in the decedent's gross estate for tax purposes. The Court reasoned that the statute operated arbitrarily by not allowing the estate's executor any opportunity to establish that the gifts were not, in fact, made in contemplation of death. Moreover, the result was further justified by the fact that the estate was burdened by a tax measured

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5/ The issue and reasoning in Schlesinger v. Wisconsin, 270 U.S. 230 (1926), is substantially the same, dealing, however, with a section of the Wisconsin tax code. In addition, petitioner has on brief argued that we approved the theory of Heiner v. Donnan, 285 U.S. 312 (1932), in Charles Wilson, 39 T.C. 362 (1962). However, we did not pass upon the constitutional issue presented there and, therefore, find it unpersuasive.

in part by the value of property which was never owned by the estate.

More recently in Vlandis, supra, the Court found unconstitutional a Connecticut statute which classified prospective students as permanent nonresidents for purposes of tuition payment in the state university when their legal address was outside the state at the time their application for admission was made or at some point during the preceding year. Seemingly, the Court was primarily concerned with whether the individuals were accurately grouped and it stated:

> We hold only that a permanent irrebuttable presumption of nonresidence--the means adopted by Connecticut to preserve that legitimate interest--is violative of the Due Process Clause, because it provides no opportunity for students who applied from out of State to demonstrate that they have become bona fide Connecticut residents. * * * [Vlandis v. Kline, 412 U.S. at 453.]

The standard employed was meticulous; the due process clause would be violated if the conclusive presumption were not necessarily and universally true in fact. The remedy afforded was to ascertain whether the treatment of the individual was consistent with the statute's purpose.

Justice Rehnquist, in his dissent, argued that the majority's analysis of and its reliance on Donnan were reminiscent of and inexorably linked to the long-repudiated principles of "substantive due process" and contrary to the teaching of Ferguson v. Skrupa, 372 U.S. 726 (1963), which held that courts should not substitute their social and economic

beliefs for those of the elected legislative bodies.

From a close examination of the conclusive presumption cases, it is apparent that the concern with the statutory accuracy of what is, in essence, a delineation of a class of persons who are to bear a burden or receive a benefit under prescribed circumstances closely resembles the analysis applied in equal protection cases.

Finally, in Weinberger v. Salfi, 422 U.S. 749 (1975), Justice Rehnquist, writing for the majority, noted that various holdings in similar cases dealing with irrebuttable presumptions did not "sound precisely the same note" and, therefore, discussed at some length the proper test to be applied in cases of this sort. Returning to a more traditional equal protection analysis, the Court stated:

> The question is whether Congress, its concern having been reasonably aroused by the possibility of an abuse which it legitimately desired to avoid, could rationally have concluded both that a particular limitation or qualification would protect against its occurrence, and that the expense and other difficulties of individual determinations justified the inherent imprecision of a prophylactic rule. * * * [422 U.S. at 777.]

The Court also quoted with approval from Richardson v. Belcher, 404 U.S. 78 (1971), where it was held that an act of Congress will not be so arbitrary as to offend due process where the legislative classification is rationally related to the achievement of legitimate legislative goals. Moreover, a

legislative enactment need not be in every respect logically consistent with those goals to be constitutional. Williamson v. Lee Optical Co., 348 U.S. 483, 487 (1955).

It is also important to consider that in neither Donnan nor Vlandis was the Court confronted with the same kind of clear constitutional power which is granted to Congress to define income subject to taxation. The salient distinction in Donnan is the fact that the taxpayer's estate never owned the property, while petitioner herein is merely charged in advance with an incremental value which in some sense is inherent in the property and in all probability the real measure of the compensation intended by the parties. Moreover, the tax consequences were clearly delineated in the Chesebrough stock purchase plan and presumably petitioner was aware of the measure of her compensation.

Prior to enactment of section 83, contractual restrictions were utilized to maximize both tax deferral and capital gain potential on the ultimate disposition of the shares. Cognizant of such abuse, Congress chose to recognize only those restrictions which it felt were not utilized to produce such unwarranted tax benefits.

H. Rept. No. 91-413, 91 Cong. 1st Sess. (1969), 1969-3 C.B. 255 states:

> Explanation of provision.--For the above reasons, your committee's bill provides that a person who receives a beneficial interest in property by reason of the performance of services is to be taxed with respect to the property at the time of receipt, either if his interest in the property is transferable

or if it is not subject to a substantial risk of forfeiture. In this case, the person is to be required to include in income the amount by which the fair market value of the property exceeds the amount (if any) he paid for the property. For this purpose, the fair market value of the property is to be determined without regard to any restriction, except a restriction which by its terms never lapse, for example, a requirement that an employee sell the stock back to the employer * * * are not, in your committee's opinion, tax-motivated and should be distinguished from restrictions designed to achieve deferral for tax saving purposes. [Emphasis added.]

Undoubtedly, the efficacy of the Congressional design to eliminate the dual benefits of tax deferral and capital gain would have been dangerously undermined without a strict measure of the income resulting from such agreements. There can be no doubt that Congress may adopt a measure calculated to prevent an avoidance of tax. Helvering v. City Bank, 296 U.S. 85, 90 (1935). The plethora of contractual restrictions which could be designed would create substantial problems of valuation; an alternative Congress may seek to avoid. Helvering v. Lerner Stores Co., 314 U.S. 463, 468 (1941). Moreover, the recognition of contractual restrictions would build into every share of stock a deferral and potential capital gain increment, albeit on a smaller scale, resulting from the immediate imposition of tax under the proscribed statutory conditions.

Traditionally, to invalidate a taxing statute, it must be shown that Congress did a wholly arbitrary thing or found equivalent

where there was none or anything approaching it. United States v. Manufacturers National Bank, 363 U.S. 194 (1960); Burnet v. Wells, 289 U.S. 670 (1933).

As respondent points out, there are other examples of conclusive presumptions in the tax code. The Civil Service Retirement Act is a prime example wherein the employee is presumed to have consented to payroll deductions for contributions to the retirement plan while taxed currently on those amounts. A tax on the full amount has been sustained in Hogan v. United States, 513 F.2d 170 (6th Cir. 1975), and Lawrence J. Cohen, 63 T.C. 267 (1974), although based primarily on the facts and not the constitutional validity of a tax on amounts arguably in excess of the current economic benefit. However, the continued use of conclusive presumptions as a statutory technique in taxing statutes lends credibility to the notion that their use in this regard is not arbitrary or unreasonable.

We are unable to say that Congress, in responding to an area of tax avoidance created by the use of such restrictions which it now refuses to recognize, acted arbitrarily. While some unfairness and inequity may result from the operation of section 83, Congress could rationally have concluded that such a result was justified by the ease and certainty of the section's operation. Weinberger v. Salfi, 422 U.S. at 777. We are convinced, moreover, that section 83 is a rational response to an area of substantial tax abuse. Moritz v. Commissioner, 469 F.2d 466 (10th Cir. 1972), cert. denied 412 U.S. 906 (1973).

We conclude that section 83 is a valid exercise of the taxing power and consonant with the principles established in Weinberger,

supra, and Burnet, supra. In any event, the question is clearly not so free from doubt so as to rebut the real and vital presumption in favor of the validity of a taxing statute. Penn Mutual Indemnity Co., 32 T.C. 653 (1959). Accordingly, we hold that section 83 is constitutional.

Decision will be entered under Rule 155.

APPENDIX C

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the sixth day of April, one thousand nine hundred and seventy-eight.

Present:

HON. WILFRED FEINBERG
HON. JAMES L. OAKES
Circuit Judges

HON. INZER B. WYATT
District Judge

77-4143

MIRIAM SAKOL,

Petitioner-Appellant,

-against-

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Appeals from the Tax Court of the United States.

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said Tax Court of the United States be and it hereby is affirmed without costs in accordance with the opinion of this court.

A. DANIEL FUSARO,
Clerk

By ARTHUR HELLER,
Deputy Clerk

Docketed on April 6, 1978.